UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

IN RE: CITY OF DETROIT, MICHIGAN,	.	Docket No. 13-53846
	.	Detroit, Michigan
	.	October 21, 2013
Debtor.	.	1:00 p.m.
. . . . .		

HEARING RE. OBJECTIONS TO ELIGIBILITY TO CHAPTER 9 PETITION (CONTINUED)
BEFORE THE HONORABLE STEVEN W. RHODES
UNITED STATES BANKRUPTCY COURT JUDGE

APPEARANCES:

For the Debtor:	Jones Day By: BRUCE BENNETT 555 South Flower Street Fiftieth Floor Los Angeles, CA 90071-2452 (213) 243-2382
	Jones Day By: GEOFFREY S. IRWIN 51 Louisiana Avenue, N.W. Washington, D.C. 20001-2113 (202) 879-3768
	Pepper Hamilton, LLP By: ROBERT S. HERTZBERG 4000 Town Center, Suite 1800 Southfield, MI 48075-1505 (248) 359-7333
For the State of Michigan:	State of Michigan Michigan Department of Attorney General By: MATTHEW SCHNEIDER P.O. Box 30754 Lansing, MI 48909 (517) 241-8403

APPEARANCES (continued):

For AFSCME, AFL-CIO, and Sub-Chapter 98, City of Detroit Retirees:	Lowenstein Sandler, LLP By: SHARON L. LEVINE 65 Livingston Avenue Roseland, NJ 07068 (973) 597-2374
For Detroit Retirement Systems-General Retirement System of Detroit, Police and Fire Retirement System of the City of Detroit:	Clark Hill, PLC By: ROBERT D. GORDON 151 South Old Woodward, Suite 200 Birmingham, MI 48009 (248) 988-5882
For the Detroit Fire Fighters Association, the Detroit Police Officers Association and the Detroit Police Lieutenants & Sergeants Association:	Erman, Teicher, Miller, Zucker & Freedman, P.C. By: BARBARA A. PATEK 400 Galleria Officentre, Suite 444 Southfield, MI 48034 (248) 827-4100
For the International Union, UAW:	Cohen, Weiss & Simon, LLP By: BABETTE A. CECCOTTI PETER D. DECHIARA 330 West 42nd Street, 25th Floor New York, NY 10036-6976 (212) 356-0227
For Detroit Retired City Employees Association, Retired Detroit Police and Fire Fighters Association, Shirley V. Lightsey, and Donald Taylor:	Silverman & Morris, PLLC By: THOMAS R. MORRIS 30500 Northwestern Highway, Suite 200 Farmington Hills, MI 48334 (248) 539-1330 Lippitt O'Keefe, PLLC By: RYAN C. PLECHA 370 East Maple Road, Fl. 3 Birmingham, MI 48009 (248) 646-8292

APPEARANCES (continued):

For the Official Committee of Retirees:	Dentons By: CLAUDE D. MONTGOMERY ANTHONY B. ULLMAN 1121 Avenue of the Americas New York, NY 10020-1089 (212) 632-8390 Brooks, Wilkins, Sharkey & Turco, PLLC By: MATTHEW E. WILKINS 401 South Old Woodward, Suite 400 Birmingham, MI 48009 (248) 971-1711
For Retired Detroit Police Members Association:	Strobl & Sharp, PC By: LYNN M. BRIMER 300 East Long Lake Road, Suite 200 Bloomfield Hills, MI 48304-2376 (248) 540-2300
For the Flowers Plaintiffs:	Law Offices of William A. Wertheimer By: WILLIAM WERTHEIMER 30515 Timberbrook Lane Bingham Farms, MI 48025 (248) 644-9200
For Ambac Assurance Corp.:	Schafer and Weiner, PLLC By: DANIEL J. WEINER 40950 Woodward Avenue, Suite 100 Bloomfield Hills, MI 48304 (248) 540-3340
Court Recorder:	Letrice Calloway United States Bankruptcy Court 211 West Fort Street 21st Floor Detroit, MI 48226-3211 (313) 234-0068
Transcribed By:	Lois Garrett 1290 West Barnes Road Leslie, MI 49251 (517) 676-5092

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THE CLERK: All rise. Court is in session. Please be seated. Recalling Case Number 13-53846, City of Detroit, Michigan.

THE COURT: And you may proceed.

MR. GORDON: Thank you, your Honor. Good afternoon. For the record, Robert Gordon of Clark Hill on behalf of the Detroit Retirement Systems. Your Honor, we did not submit a proposed line-up to the Court as we did for the October 15th hearing; however, the objectors have all conferred with one another over the weekend and have come up with an informal line-up, if you will, and have discussed amongst themselves sort of loosely how much time each party would need. And so rather than inform the Court of the time slots, we'll just sort of try to self-police ourselves and inform the Court if that's okay.

THE COURT: Okay.

MR. GORDON: Again, as with the October 15th hearing, each party will try its best to identify before it starts its rebuttal argument -- apprise the Court of what issues it plans to touch upon. Unlike the October 15th hearing, of course, because time is short, various parties will be trying to touch upon discrete issues and not overlap with one another, so while each party may support the arguments that are being made, for the record, I just need to state that each party obviously reserves its right to make

similar arguments or diverge from those arguments in its supplemental briefing. Thank you.

With that, your Honor, just so the Court has an understanding of the order in which we are proposing the objectors rise, first would be Ms. Levine on behalf of AFSCME, then Ms. Brimer on behalf of the Retired Detroit Police Members Association, then myself on behalf of the Retirement Systems, then Mr. Morris on behalf of the Retiree Associations, then Ms. Patek on behalf of the Public Safety Unions, then Ms. Crittendon as an interested party, and then Mr. Montgomery on behalf of the Retiree Committee.

THE COURT: All right.

MR. GORDON: Oh, my goodness. I'm sorry. After -- I'm sorry. After Mr. Morris, Ms. Ceccotti would be next on behalf of the UAW.

THE COURT: Thank you. It's fine with me not to keep track of your time individually if that's your request, but I do have to cut off all rebuttal argument in one hour.

MR. GORDON: Very well, your Honor. Thank you.

THE COURT: And one more thing. You will notice that on your tables we now have three microphones instead of one. I have been asked to advise you that this makes it much more likely that our record will pick up your private conversations, and you should be concerned about that because we do post the audio unedited on our website every night.

And I should say if there is a private conversation that you want to have at any point today or during the trial and you're concerned about it getting on the microphone, just request a brief pause from the recording. We'll turn the recording off. You can have your conversation, and we'll continue.

MS. LEVINE: Good afternoon, your Honor. Sharon Levine, Lowenstein Sandler, for AFSCME. Your Honor, I've been given ten or twelve minutes and will address, per the Court's suggestion, home rule and then perhaps if there's time a sentence on Chapter 9 again.

THE COURT: Okay.

MS. LEVINE: Thank you, your Honor. Your Honor, similar to the arguments or the statements in the conversation we had with the Court with regard to Chapter 9 and the interplay between the federal Constitution and the state municipal governments under the Tenth Amendment, we would respectfully submit that under the Cooley Doctrine and the cases that have been decided here in Michigan that the Michigan Constitution in Chapter 7 also reflects a very strong view towards home rule, and what we mean by home rule, your Honor, is that the local governments -- in this case, Detroit -- are given a lot of respect by the state government in order to manage and run their own local governments. And we would respectfully submit that the way that either 439 is

written or as applied in this case, that the grant of power given the emergency manager here in Detroit violates the state Constitution.

So, first, your Honor, we would note that the emergency manager has been appointed by the state. He was not elected by the local electorate. He was not elected the way, for example, the mayor and the City Council were elected. He has supplanted them, and he was -- and he didn't supplant them by a vote of the citizens, and he didn't even supplant them with the consent of the locally elected officials. So first point is that we believe that the emergency manager and 436 is inappropriate here because he's not an elected official.

Two, your Honor, we would note that the breadth of the powers granted the emergency manager even if the appointment of the emergency manager were appropriate is inappropriate here both as a matter of constitutional law and as applied in this particular case because the governor failed to appoint the emergency manager with any appropriate contingencies in the letter of appointment, and that's because of the scope of the power that the emergency manager wields is well in excess of that which the Constitution -- the Michigan Constitution would permit. So, for example, even if the scope of the powers were not subject to -- sorry. Let me say it differently. Even if the Michigan Constitution

does allow, for example, taxation or even debt adjustment, it doesn't allow the wholesale taking over of the local government by the emergency manager. So, for example, not allowing there to be replacements to the City Council, day-to-day negotiation of vendor contracts, labor contracts, grievances, de minimis asset sales, these are the types of things that are not necessarily --

THE COURT: Well, but let me ask you to -- let me ask you to pause there with this question. Is the constitution -- or would the constitutionality of PA 436, as it pertains to those kinds of issues, be before this Court? Are they necessary to decide in the context of eligibility?

MS. LEVINE: They are, your Honor, because the way this appointment has taken place, all of those individual acts that the emergency manager has been allowed to engage in ahead of a plan of adjustment which might deal with just the debt makes the very decision that the emergency manager made with regard to filing the Chapter 9 petition itself unconstitutional or unconstitutional as applied to the facts of this case because there was no limitation on what the scope of his authority was just dealing with that one issue. And that scope -- the unfettered scope, your Honor, is not just related to the day-to-day business operations, and we've seen that play out in the deposition of Mayor Bing and in others who talk about the fact that they're bottlenecked with

regard to decision-making and that ordinary types of decision-making is now deferred to the emergency manager or his counsel, but we've seen that, your Honor, in the unfettered scope that provides for no judicial review of those decisions as well. So, for example, if, in fact, there's a dispute under a Chapter 11 or a Chapter 7 where you have a debtor in possession or a trustee, a debtor in possession, for example, a corporate debtor, has fiduciary obligations under the direct language of the Bankruptcy Code and has fiduciary obligations under state law. A Chapter 7 or a Chapter 11 trustee similarly has fiduciary obligations, and they are not allowed to take actions either outside the ordinary course of business or under the course of a Chapter 7 without coming to this Court for approval, sales, settlements, ultimate plans of reorganization. Under Chapter 9, because we're dealing with the fact -- and we believe it's the unconstitutional fact -- that there's a tension between what the state can do and what the federal government can do, we don't have that same access to judicial review, so under 904, 362, and even Stern's there are a lot of decisions that get made on the day-to-day basis. And I'm not dealing with the global jurisdictional issues, just the day-to-day basis of tort claims, of contract disputes, of settlements with individual creditors that don't ever see the light of day in this court, and to the extent that there was a grievance or a

dispute about that under 362 in this Court's stay extension orders, there's no other court where those disputes can be taken.

So we have an unelected emergency manager who's in place now because he's a contractor with the state government, and we have unfettered rights where basically our view is it's tantamount to all of the rights that were granted to the city under Chapter -- under Article VII of the Constitution are now within the power of the EM in this particular case. And we'd respectfully submit that that is just not what the Cooley Doctrine or the state Constitution envisioned even if it did envision in appropriate circumstances debt restructuring.

Nine minutes. With that, your Honor, I would just close briefly on Chapter 9. We would respectfully submit that similar -- well, I'll --

THE COURT: I'm not sure you've quite addressed the central home rule question that at least I see. The city and the state argue that to whatever extent home rule powers apply to the City of Detroit under the Michigan statutes, they are effectively modified by PA 436 and that that modification is not inconsistent with whatever the Michigan Constitution says about home rule. How do you deal with that?

MS. LEVINE: Your Honor, we understand the statement

has been made along those lines. We don't see those modifications in PA 436. In other words, either in the statute itself or in the authorization as granted under the statute here, there is no limitation that we can see, and, in fact, we've seen the opposite through the emergency manager's orders and the emergency manager's right to run unfettered the City of Detroit. And in addition to that, one of the issues that they talk about in terms of limiting his ability is that his term is only 18 months, but that also is not supported if you take a look at the statute and you take a look at the statute in practice without any limitation in the authorization because at the end of 18 months, the state has the absolute right to continue the term. The City Council can only stop that by a two-thirds vote, but since the EM has effectively taken over the City Council, we don't even have the checks and balances that appear facially on the statute, so we're saying two things. We're saying they can say that it's a limitation, but as far as we can tell, PA 436 virtually gives away to the emergency manager everything that was referred to the states under Chapter 7 of the Constitution, and not only that, there is no redress for addressing violations of that unfettered right or stopping the time line pursuant to which the EM can stay in office. Thank you.

MS. BRIMER: Good afternoon, your Honor. Lynn M.

Brimer appearing on behalf of the Retired Detroit Police Members Association. Your Honor, to begin with, I have approximately ten to twelve minutes of the allotted time for the objectors. I am going to discuss, your Honor, the narrow issue of whether or not PA 436 is constitutional under the referendum provision of the Michigan Constitution. As your Honor will recall, Article II, Section 9, of the Michigan Constitution specifically reserves to the people of Michigan the right of referendum with respect to any law other than those that contain a spending or appropriation provision.

When we were here on Tuesday, your Honor, last week, I advised the Court that at that time the city and the state neither had responded to the arguments that had been raised by the RDPMA in its opening objection and, moreover, that at that point in time we had not been able to find a case that was factually similar to this case. Today, we do have the oral arguments that were presented by Ms. Nelson in response to this argument during the state's opening arguments. The city has still not responded to this discussion, and we still, your Honor, do not have a case that is even closely factually similar to this case.

As the Court may recall, Ms. Nelson cited the case of Reynolds v. Martin for the proposition that the governor and the state legislature can completely disregard the will of the people and thwart the people's constitutional right to

a referendum by placing an insignificant spending provision at the tail end of an act that had previously been defeated on referendum, pass such act during a lame duck session, and consider it to be constitutional. Reynolds v. Martin is so factually distinguishable, your Honor, as to be of little or no actual application to this case, and ultimately we would conclude that its holding, in fact, supports the argument of the RDPMA. And I think it's very important to very briefly discuss that case. In Reynolds in 1994 the legislature passed an act amending the state's Bingo Act. That act was referred for referendum. However, before it was placed on the 1994 ballot, certain of its signatures were questioned. Therefore, it did not make the 1994 ballot. The general election was held in November of '94. A new legislation -- legislators were elected. They were seated in 1995. In 1995 with the new legislation in -- legislative body in place, a new act was passed. Subsequently, in 1996 the 1994 act was certified for the referendum, and it was, in fact, voted down in the referendum.

A party challenged the denial of a license under the 1995 act on the grounds that it could not have been passed in contravention of the referral of the 1994 act to the referendum process under Article II, Section 9. However, your Honor -- and ultimately the 1995 act was upheld as constitutional.

The state would argue that that case is factually applicable and the holding consistent with their position that PA 436 is constitutional. However, there are two significant distinctions between the holding and the facts in Reynolds and the matter before this Court with respect to 436. One, there was a general election after the matter had been referred to referendum. A new legislative body was in place, and it was the new legislative body that had been, in fact -- that passed the new act. But more significantly, your Honor, the 1995 act did not contain a spending provision, and it was not, therefore, removed from the referendum provisions of the Michigan Constitution. In fact, in Reynolds the appellate court relied on the Michigan Supreme Court holding in Michigan Farm Bureau versus Secretary of State at 379 Mich. 387, 1997, and noted that should the legislators not be responsive to the will of the people expressed at the referendum vote, the second legislation itself is subject to the same right of referendum as the original act. That is simply not what we have with respect to 436.

The question, your Honor, is why wasn't 436 subject to the referendum vote? It was not subject to the referendum vote because the governor, the Michigan Department of Treasury, and their consultants devised a scheme in the event that PA 4 was defeated on referendum, that would remove a new

law from the referendum. And how do we know that there was a scheme that was devised? We have communications that have been produced during discovery that confirm that the spending provisions in Section 34 and 35 were included in order to avoid the referendum vote. For example, as early as March 2nd, 2012, in communications between Mr. Ellman at Jones Day and Ms. Ball at Jones Day, Mr. Ellman was discussing the possibility that PA 4 would be defeated on referendum and what the options would be in the event it was rejected by the people. He states in discussing the options, your Honor, "The cleanest way to do all of this probably is new legislation that establishes the board and its powers and" -- with the "and" in capital letters, your Honor -- "includes an appropriation for the state institution. If an appropriation is attached to, parenthetical, included in the statute to fund a state institution, parenthetical, which is broadly defined, then the statute is not subject to repeal by the referendum process."

In fact, Mr. Orr himself has acknowledged this concern with respect to PA 436. On January 31st, 2013, he e-mailed Ms. Ball stating the following: "Michigan's new EM law is a clear end-around the prior initiative that was rejected by the voters in November." He then discusses some of the provisions of PA 436 and concludes with the following statement: "So although the new law provides the thin veneer

of a revision, it is essentially a redo of the prior rejected law." Your Honor --

THE COURT: What was the date of that?

MS. BRIMER: That, your Honor, was January 31st, 2013. So, your Honor, despite Ms. Nelson's contention that the spending provisions were not added in an effort to avoid the referendum vote, we would suggest that the evidence and the discovery proves otherwise.

Ms. Nelson also argued that the $5,780,000 spending provisions were meaning provisions not designed to avoid the referendum. First, I would suggest quite to the contrary, your Honor. A review of the state's financial statements for the fiscal year ending 9-30, 2012, suggests that $5,780,000 represents approximately .011 percent of the state's expenditures for the prior fiscal year. With respect to the pensioners that are before this Court making an average of $18,000 in their pension, that would represent $1.98. I would suggest that's hardly a meaningful spending provision.

But second and more significant is that we have the words of the debtor's attorney in the e-mails that I read to you that the spending provisions were added with the intent of avoiding the referendum. We also have testimony from the state's 30(b)(6) witness, Howard Ryan, the legislative liaison for the Department of Treasury during the period for the drafting of 436, in which he testified in his deposition

on October 14th that the spending provisions were added to avoid the referendum.

"Question: Based on your conversations with the people at the time, was it your understanding that one or more of the reasons to put the appropriation language in there was to make sure it could not -- that the new act could not be defeated by referendum?

Answer: Yes.

Question: Where did you get that knowledge from?

Answer: Well, having watched the entire process unfold over the past two years.

Question: The governor's office knew that that was the point of it?

Answer: Yes."

Your Honor, we would suggest that those spending provisions were, one, de minimis, and, two, added solely for the purpose of removing this act from the constitutional right of the people to a referendum vote.

I'm uncomfortable with the amount of time I have left here, your Honor. Two more points. Ms. Nelson argued that PA 436 has substantially changed PA 4. We prepared a comparative analysis, your Honor, of the relevant provisions, those with respect to the appointment of an emergency manager

and those with respect to the authorization for the filing of a Chapter 9. Those provisions are virtually identical. Our comparative analysis has been attached and submitted to the Court as Exhibit B to our pretrial brief. Those provisions were, in fact, your Honor, subject to the provision in the Constitution which provides that no law as to which the power of referendum properly has been invoked shall be effective thereafter unless approved by a majority of the electors voting thereon in the next general election.

Your Honor, the Michigan Supreme Court, which should be our controlling court here, has, in fact, suggested that the right of referendum is so important to this state and so important to our constitutional rights that in Kuhn -- I'm trying so hard to get through my time -- that in the matter of Kuhn v. Department of Treasury the Court said that this is a reserved right to the people which must be liberally construed. This Court must liberally construe the right of the people to the referendum, find that the Michigan Supreme Court would, in fact, determine that PA 436 violates Article II, Section 9, of the Michigan Constitution, and, therefore, cannot have been a proper basis for authorization of the filing of this Chapter 9 under Section 109(c) of the Bankruptcy Code.

THE COURT: Thank you.

MR. GORDON: Again, for the record, Robert Gordon of

Clark Hill. Your Honor, I want to touch upon, if I may, an issue that was raised on the 15th regarding who is essentially the impairer of contracts in a Chapter 9 process and then touch upon one other small matter that came up in colloquy on that day.

Your Honor, during the oral argument, city's counsel argued that in a Chapter 9 case, the law views the federal government as the sole relevant actor impairing contracts of the debtor municipality and that, therefore, the prohibition in the pensions clause against the state and its subdivisions impairing accrued pension benefits is of no moment in this matter because it will be the federal government and not the state or the city that is doing the impairing.

In making the argument, the city's counsel relies on the language of a dissenting opinion of Justice Cardozo in the Ashton case and then suggests that the viewpoint expressed therein is adopted by the Bekins court, which overruled Ashton. We submit that the analysis is incorrect. First, it is not entirely clear that the expansive interpretation of Justice Cardozo's opinion suggested by the city comports with his intended meaning. However, even if that interpretation is accurate, there is no indication that his views were adopted in Bekins, a decision in which Justice Cardozo did not even participate.

Contrary to the city's argument, as we've pointed

out in our papers, it is the municipality alone that can file a plan and propose the impairment of claims, and it is the municipality alone that can solicit votes and ask the Court to approve such a plan. Indeed, your Honor, the reality of the active role played by the debtor is reflected clearly in Section 109 itself. 109(c)(5) provides, and I quote, "(a) An entity may" -- excuse me. It provides under 109(c), I quote, "An entity may be a debtor under Chapter 9 of this title if and only if such entity," and then under (5)(A) it says, "has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter," and there's similar language under 109(c)(5)(B). Both of those provisions talk about the municipal debtor being the one who intends to impair under the plan. It doesn't say that the municipal entity intends to ask the Court to impair. So 109(c)(5) reflects the reality that we just discussed.

Moreover, contrary to the city's argument, your Honor, Chapter 9 jurisdiction turns on the basic concept that the state can consent to subjecting a political subdivision to federal bankruptcy law. Having thus consented, federal law will then apply, but it is still the state and its local governmental unit that is actively availing itself of the Bankruptcy Code in the Bankruptcy Court. The city has not

and we submit cannot cite to any case law that describes a Chapter 9 debtor as standing mute and passive in the Bankruptcy Court during the plan process and simply accepting whatever impairment of contracts the Court may mete out. It's an unsupportable and unsupported proposition, we submit.

Since the state and its political subdivision is clearly the impairer of contracts in the Chapter 9, then absent the relief that's been requested by the Retirement Systems and other objectors, the state or the city in this case would be directly breaching the pensions clause, which it cannot do. To the extent it is asking the federal court to assist, it cannot do so since the state government and its subdivisions are bound by the pensions clause and cannot delegate to another entity authority that they do not have to abrogate Michigan's Constitution. And we've cited several cases in our reply brief at page 15 for the axiom that the state and its various branches cannot do indirectly what they cannot do directly.

Since the state and the city cannot violate the Michigan Constitution and specifically the pensions clause outside of the Chapter 9 process, they can no more do so in Chapter 9, and the requirement that the Retirement Systems and other objectors have advocated for -- i.e., an explicit conditioning of the bankruptcy upon the protection of the pensions clause -- is absolutely proper and mandated by

Section 109(c)(2)'s respect for state law. Any other conclusion we submit eviscerates 109(c)(2) and its requirement to uphold the Tenth Amendment and the sovereignty of state law. Moreover, your Honor, there was --

THE COURT: So is the end result of that argument that no municipality in Michigan can file a Chapter 9?

MR. GORDON: The end result would be that they cannot file a Chapter 9 without the explicit understanding that they will not impair accrued pension benefits in violation of the pension clause.

THE COURT: Well, but that violates the Bankruptcy Code.

MR. GORDON: How so, your Honor?

THE COURT: Well, it gives a priority to one unsecured creditor over all the others, or one group of unsecured creditor over all the others.

MR. GORDON: We disagree, but the priority issue I'm going to defer to Mr. Morris on. He was going to speak about that issue, but we disagree that it can be characterized as a priority issue, your Honor. I just don't want to steal his portion.

THE COURT: Okay.

MR. GORDON: But it is not a priority --

THE COURT: No pressure, Mr. Morris.

MR. GORDON: It is not a priority issue, your Honor.

Moreover, your Honor, the city's counsel had suggested, I believe, on October 15th that Section 943(b) may not contain any bar to adjusting debts but only technical restrictions on how debt adjustment may be implemented. If he is correct -- and we think not -- then all the more reason why the protection of pension benefits under the pensions clause must be addressed at the eligibility stage.

The only other thing, your Honor, I wanted to touch upon was at, I think, page 103 of the written transcript of the hearing on the 15th we had a discussion in which I likened the accrued pension benefits to a nondischargeable debt, and the Court questioned whether that concept was truly applicable in a Chapter 9. I wish to simply note to the Court that while Section 523 of the Bankruptcy Code was not incorporated into Chapter 9, Section 944(c) provides that the debtor is not discharged under Subsection (b) of this section from any debt excepted from discharge by the plan or order confirming the plan. So, indeed, concepts of nondischargeable debt do exist under Chapter 9 of the Bankruptcy Code, and because it is not governed by Section 523 of the Bankruptcy Code, it must be assumed -- because there's no other basis identified in the Bankruptcy Code itself, it must assumed that the bases for nondischargeability would arise under state law such as the absolute and impermeable protection of accrued pension

benefits under the state's Constitution.

THE COURT: Why isn't it safer to assume that that provision is in there to facilitate parties' negotiations regarding how to treat debts?

MR. GORDON: I don't know that it's mutually exclusive. It could be nondischargeability. It could be as a matter of law --

THE COURT: Okay.

MR. GORDON: -- or by negotiation, your Honor.

THE COURT: Okay.

MR. GORDON: We would simply submit that with respect to a state constitutional protection, it can't be the subject of negotiation. Thank you, your Honor.

THE COURT: Okay.

MR. MORRIS: Good afternoon, your Honor. Thomas Morris on behalf of the Retiree Association parties. There was discussion last week and, in fact, this morning, today, this afternoon, regarding the manner in which the pensions clause operates. Specifically, there were comments by Mr. Bennett which characterize the pensions clause as establishing a payment priority. Mr. Bennett would have the Court view the pensions clause as the equivalent of a state law which designates a public pension obligation as a priority claim in bankruptcy. This is an incorrect characterization of the pensions clause.

The pensions clause is a state law which controls the city in the exercise of its political or governmental power. The pensions clause establishes a constitutional and, therefore, fundamental rule addressing the authority of a municipality to reduce or impair its pension obligations. It is an essential definition of the state -- of the duties of the state and its subdivisions. The pensions clause simply doesn't provide for a priority payment. The usual way for a state to provide for a priority is to specify that the debt is entitled to priority. An example is found in the Worker's Compensation Disability Act, MCL 418.821, which provides that liability of an employer for Worker's Compensation claims or Worker's Compensation payments shall be paramount to other claims except for wages and taxes. Another way to ensure a priority is to provide for a statutory lien, so we've got lien -- a lien under Section 211.40 of the Michigan Compiled Laws for property taxes that are secured by a first lien, prior, superior, and paramount. And MCL 324.3115 provides that certain fines for environmental liabilities constitute a lien on all property of any kind or nature owned by the defendant. And a construction lien is entitled to priority under state law.

In Orange County -- in the case if Orange County found at 151 B.R., there's a quote on page 1017. In Orange County there was a statute at issue, a California statute

that was found by the Orange County court to be preempted by the Bankruptcy Code. Now, that statute provided that -- provided for certain funds to be treated as trust funds, and that statute, as interpreted by the Court, apparently or was argued to provide for there to be no tracing requirement, so the Court in that case found that statute to effectively establish a priority in bankruptcy and found it to be preempted. That case is distinguishable. The Michigan pensions clause provides for no priority of payment. It simply provides an ongoing indestructible duty of the municipality or the state to not impair and not reduce pensions.

Now, the priorities provided for in Section 507 are applicable in Chapter 7 cases, for example, because Chapter 7 is a process of liquidation, liquidation of assets and the distribution of those assets, so you need to determine who's going to get the assets. Who gets paid first? That's the priority. Those priorities are also applicable in Chapter 11 because in every Chapter 11 case, liquidation is an alternative. Liquidation is the implied alternative, and it's a standard by which a plan of reorganization in a Chapter 11 case is measured. Liquidation is not provided for in Chapter 9. Therefore, priorities are not provided for in Chapter 9 with one exception. That one exception is 507(a)(2), which provides for administrative expense

priorities. That's a --

THE COURT: But doesn't the best interest test of 943(b)(7) implicate the priorities of the Bankruptcy Code?

MR. MORRIS: It doesn't. It doesn't implicate the priorities of a liquidation as an alterative unlike in Chapter 11. That's what's done -- in a Chapter 11 you look at the unsecured creditors. What would they get in liquidation?

THE COURT: Your position is that there's nothing in a municipal bankruptcy case that would prohibit one group of unsecured creditors from insisting on payment before or in full while other unsecured creditors are paid later or not in full.

MR. MORRIS: Well, in confirmation of a case where the pensions are unimpaired, you have a possible discrimination claim by other creditors. The bondholders might claim that it's unfair discrimination, and I think the response would be any bondholders who purchased their bonds prior to 1963 when the Michigan Constitution was adopted, you've got a different argument, but those bondholders who purchased their bonds after 1963, which is all of them, don't have an argument. They're aware of the political climate. They're aware of the Constitution. They're aware that the municipality cannot --

THE COURT: Right, but the city's response to that

is the people who lobbied for and got the pensions clause in the Constitution were aware of the Chapter 9 possibility. How do I deal with that, or how do you deal with that?

MR. MORRIS: Mr. Gordon dealt with that.

THE COURT: Okay. I will look at what he said.

MR. MORRIS: But I don't want to -- I don't want to repeat it, but the city is not permitted to restrict or impair the pensions. They are an inviolate obligation that the city will live with even if it reorganizes under Chapter 9. That's just a fact. If the City of Detroit were to cease to exist, if there were to be some horrendous natural catastrophe that wiped the city off the state -- wiped the city off the map, then we believe the city would still owe that obligation, and it might cause a constitutional crisis. Maybe the state would have to -- let's say the city remained with only one resident, and that one resident couldn't possibly pay the taxes to pay this. It would cause a constitutional crisis. There'd have to be a resolution. Maybe the state would step in. I don't know. That's beyond conjecture.

THE COURT: The city says we're there now. I'm sensing from Ms. Ceccotti having risen that your time may be up.

MR. MORRIS: Yes, it is. Thank you.

MS. CECCOTTI: Your Honor, I actually rose because I

was planning to address the question that you just asked --

THE COURT: Okay.

MS. CECCOTTI: -- about -- and I was going to actually spend less time on it, but I think I'll just dispense with -- I was going to -- first of all, for the record, Babette Ceccotti, Cohen, Weiss & Simon, LLP, for the UAW, and good afternoon again.

I was going to spend some time on talking about the pension clause, the language of the pension clause, and how the courts in Michigan address constitutional provisions when called upon to review them and the principles that they apply, but I'm going to move actually right to your Honor's question because I do think that a lot of -- some of the questions that your Honor has asked, particularly this afternoon, really do go to what I think is going to be the crux of this.

First of all, on the city's point that the pension clause doesn't seem to make any -- doesn't, in fact, make any reference to the possibility of municipal bankruptcy, I think we have to go and ask ourselves a couple of questions. First, what did municipal bankruptcy mean at the time, and what did pension rights mean at the time? And so we have to, you know, sort of bring ourselves back in the legal regime -- in two legal regimes to 1963. First, the city's brief cites to a law that was on the books in Michigan, PA 72, dating

from 1939, and the law refers to the 1898 Bankruptcy Act and basically says that any taxing agency or instrumentality as defined in the bankruptcy law may proceed to do something called secure a composition of its debts, and the law then goes on to describe rules about who can file the petition and who can agree to the plan of composition and what kinds of things can be in the plan of composition and also provides that the composition is binding on the instrumentality.

In 1963 -- okay. So that's the law that's on the books. In 1963 as well the municipal bankruptcy law that is being referenced looks a lot more like the '37 law than it does the law that we have today. On the sort of time line of Chapter 9 changes starting with the law that was declared constitutional by the Supreme Court in '37, while there are some changes that take effect in 1946, you really don't get a major overhaul until 1976 and the events surrounding the New York City fiscal crisis, so from that point forward -- from that amendment forward, Chapter 9 looks a lot closer to the Chapter 9 that we're dealing with today, but in 1963 it really didn't look like that. And, frankly, the notion that -- and this is where we get to the pension regime part of my answer. The notion that the pension clause coming in as it did to take a situation where employees working for the state had, in effect, no vested right to deferred compensation they had earned with services that they provided

to the state, that was -- that's the gratuity and the gift -- that changes with the pension clause, which then provides the protection for accrued financial benefits. This is a new thing under the state Constitution. So it's not -- to me it's not surprising at all that you wouldn't find a reference to the plan of composition or municipal bankruptcy because we have really these arcane terms that it is very unlikely anyone would have applied to vested pension rights. It's not until 11 years later that ERISA is enacted in the federal regime. ERISA, of course, has language -- sets forth a comprehensive scheme to protect pensions and uses words like "nonforfeitable benefits" and "vested pensions" and "accrued pensions" and the like. And as we talked about last week, that regime includes the pension termination system, and you get then developing in the private sector bankruptcy world, the Chapter 11 world, the Chapter 7 world, where the priorities do function, what is the status of a pension contribution given the fact that it is based on services that were rendered to the debtor pre-petition? All of that law comes up after 1963. There just simply wouldn't be a way to think about a pension benefit in the context of a debt composition, or at least that is -- that seems very likely to me because you just don't get this law -- all of this law coming up until you get to ERISA and the concept of plan termination and the priorities that apply in Chapter 11 and

Chapter 7 years and years later. And now, you know, to my way of thinking about it, unfortunately, we have seen a lot of pension terminations, and so there's a lot of law on that subject now, but it didn't exist in 1963, and it couldn't possibly have been fairly contemplated. So I think that we're then left with a section, which is the pension clause, Article -- of the pension clause of the Michigan Constitution that is very much standing on its own without reference to any exception, and we can see why, I think, no -- in particular no reference to the concept of municipal bankruptcy working very much, in effect, each word being given effect by the courts of Michigan who have construed it a number of times to protect accrued pensions. And it's standing on its own effectively against impairment or diminishment by, as we spoke about last week, the state, the state officials, or governance -- government and political subdivisions to which it applies, so I think the --

THE COURT: I have to interrupt you and ask this question about bankruptcy. Is there anywhere else in the Bankruptcy Code where a party's nonbankruptcy law right to payment is given an absolute status in the bankruptcy?

MS. CECCOTTI: Well, your Honor, I think that there are a number of places in the Bankruptcy Code where state law is referenced, and we had a reference to the effect given to certain types of liens, which are given effect, but I think

the --

THE COURT: Well, but even there there are many circumstances in which security interests are not given absolute effect in bankruptcy.

MS. CECCOTTI: Your Honor, here's --

THE COURT: Cramdown, of course, is a perfect example of that.

MS. CECCOTTI: Here's where I think the crux of this is. We have a regime in Chapter 9 that must operate by maintaining the state's sovereign control over the political and governmental affairs, including the expenditures therewith under 903. Chapter 9 is not Chapter 11, and so, therefore, the question to start with is what is the -- what limited things can be done in Chapter 9, not necessarily let's look at the whole of the Bankruptcy Code and try to sort of plug in examples that are going to cross between a Chapter 9 debtor and a Chapter 11 debtor.

THE COURT: I understand that argument, but isn't the end result of that argument that a state like Michigan that has this clause, if it is to be given absolute impact, cannot authorize its municipalities to file bankruptcy?

MS. CECCOTTI: Cannot authorize its municipalities to file for bankruptcy if a purpose is to diminish or impair accrued pensions. That's correct, and that is --

THE COURT: But what you're not saying there is that

if there is the intent not to diminish pensions, they can file municipal bankruptcy?

MS. CECCOTTI: In this case, your Honor, the intent was made abundantly clear going in. If they had hidden the intent, we might --

THE COURT: No. I understand that. I'm trying to --

MS. CECCOTTI: -- we might not be standing here today.

THE COURT: I'm trying to figure out where your argument goes because there are two possible outcomes here. One is when a municipality is subject to the state constitutional provision, it can file bankruptcy and still impair, or it can file bankruptcy without the intent to impair, or I suppose there's a third alternative, which is the one I'm asking about, which is they can't file bankruptcy because bankruptcy doesn't permit that kind of discrimination.

MS. CECCOTTI: I think -- your Honor, I think it's a false choice, frankly. I really do. And we've seen some -- we've seen enough instances, I guess, of the more modern use of Chapter 9, particularly the cases out in California, where -- and this is -- and CalPERS has been just on the forefront of this, as I'm sure you know -- where they're not touched. I just -- I don't see what is so accepted or that

it's a black and white choice between filing for bankruptcy and not filing for bankruptcy simply based on the pension question. I mean this is a -- this is a very -- this is a large, large municipality to be seeking Chapter 9 relief. There is a lot going on. This very much reminds me, Judge, of going from the very small Chapter 11's at the beginning of the '78 Code and then all of a sudden finding companies like LTV Steel filing for bankruptcy and suddenly declaring that retiree health was a general unsecured claim, someone no one had thought of before. This very much feels to me like that type of a moment where the size of this city and the magnitude of what it's trying to accomplish simply cannot be easily fit within the rules that might otherwise apply in a smaller -- in a smaller context or with less going on or with less money available for fewer options. It's very much a moment, I think, where -- it's one of those moments that I think we will look back on and say this is where Chapter 9 changed. And we are very much hoping it does not change in the direction of violating what we believe are legitimate -- a legitimate basis for a municipality to say, "I need to adjust my debt, but I am going to adhere to a state law, a state constitutional provision like the pension clause, and I can accomplish both." I very much think that those things are possible, and if we don't have a bankruptcy system that allows for that duality -- the dual sovereignty to have play

like that, then we are simply wiping aside centuries of constitutional law. And I'm really -- my colleagues are going to be very upset with me.

THE COURT: Eleven minutes left.

MS. CECCOTTI: I'm sorry.

MS. PATEK: Your Honor, given the time limitations -- again, Barbara Patek on behalf of the Detroit Public Safety Unions -- I want to address for the moment the Court's question about whether there's anywhere else in the Code, and I don't -- I believe the answer to that question is no, but I think also the Tenth Amendment answers that question. And I think even if you assume for the sake of argument that there are -- that what the -- what is being said here, that this is just a priority issue, that this constitutional promise that was made to these public servants is to be treated like general unsecured debt as if it were credit card debt, I think a careful look at the Code answers that question to the contrary, and I think you can start with the Orange County versus Merrill Lynch case, which talks about 507 and the reason for the exclusion of (a)(1) and (a)(3) through (9) from the Code. And in a footnote it talks about what were then (a)(3) and (a)(4) being excluded because they had to do with employment rights and collective bargaining agreement rights potentially of employees which could affect the ability of the municipality to continue its

operation. I suggest it's no accident that those two sections were excluded. I suggest that it's no accident -- we heard a lot about electoral will or political will last week -- that this provision is tucked away in the Michigan Constitution so it's difficult to change. This is a promise that's made to people as part of the sovereignty of the State of Michigan to the people who are necessary in this case, talking about my clients, the Public -- the members of the Public Safety Unions, and I would suggest that it would be a violation of the Tenth Amendment to read the Code otherwise. Thank you, your Honor.

MR. MONTGOMERY: Your Honor, Claude Montgomery for the Retiree Committee. I had four things that I was going to try to address today in my seven minutes. One was ripeness. One was whether or not there is an issue, despite the Cardozo dissent, and, three, I'd like to answer the question of whether or not intent matters for the governor and the emergency manager, a question raised by the state, and, finally, if I have any time left, that Studier does not undercut Seitz v. Probate Judges System.

But I'd also like to take the opportunity to answer the last question or at least offer a thought -- whether or not it's considered useful or not, I will, of course, leave to the Court -- and that Bekins itself tells us what the best interest question was, and it wasn't relative treatment of

creditors. It was whether or not bondholders could get tax people to actually levy on property that was either worthless among the municipalities or couldn't be sold for the amount or tax levy marshals and whatnot were running away from creditors. So the best interest of creditors that Bekins saw being made possible by the plan of adjustment was better than zero, not a relative priority vis-a-vis other creditors but an ability to get paid where the state was actively, through its minor officials, resisting paying anything. And so I think that is the best interest of creditors that 943(7) is looking to, and I have further statutory construction for that. At least I offer it. One is that neither 1129(a)(7) nor 1129(a)(11) are actually adopted by Chapter 9, and so the -- what is the best interest of creditors as in feasible is not necessarily identical to those statutory -- those two statutory provisions to which no reference is made.

So now I'd like, if you will, turn my attention to the Cardozo dissent, which I must say I thought Mr. Bennett made a very interesting offer to the Court as a foundation for Bekins, but I would like to suggest and only suggest, your Honor, that there is a key -- two key parts to the Cardozo consent that the Court may wish to pay attention to. One is that the Court action on which Mr. Bennett relies was the discharge of the debt. It wasn't what happened inside the plan process. It was the actual discharge, which

couldn't be accomplished without court intervention. The second thing that was critical to Justice Cardozo's thinking and, according to Mr. Bennett, ultimately adopted by the Bekins court, which was this concept of consent. Well, Justice Cardozo characterized it as a waiver of a privilege, right, but here what controls how the state exercises the waiver of the privilege? Well, obviously that has to be a question of state law. It can't be transformed into a question of federal law. And what is the state law that controls the exercise of the waiver of the privilege? Well, it's this Michigan state Constitution. So if the Michigan state Constitution is the bedrock on which the waiver takes place and the Michigan Constitution says, according to the Seitz case and according to the Musselman case, no act can be taken that results in a diminishment of pensions, not affects the value of those pensions but actually diminishes the amount of those pensions, then the state actors cannot do anything in that regard. And I would further answer the question your Honor asked earlier, was if the Michigan Constitution is a proscription on the behavior designed to undercut the Constitution, does that mean that no city can file a Chapter 9? Well, obviously ones that don't have pension issues don't even have to ask the question, so 436 and the Michigan Constitution are clearly not a bar where there's no desire to impair pensions because they don't have

pensions, but if they do have pensions --

THE COURT: Well, I'm not sure that's so.

MR. MONTGOMERY: Well, as your Honor -- forgive me.

THE COURT: I mean my question would be in that case -- I mean you can construct a hypothetical in which the city proposes to impair bonds and the bondholders are saying, "Wait a minute. There's this other asset over here, the pension assets, you know. We have to impair everybody, not just us."

MR. MONTGOMERY: I presume your Honor meant pension obligations.

THE COURT: Pension, yeah. Thank you.

MR. MONTGOMERY: The one difference between the state constitutional provision on impairment of contracts and Article IX, Section 24, is that Article I, Section 8, of the Michigan Constitution speaks of legislation whereas Article IX, Section 24 --

THE COURT: And I don't mean to frame this in terms of a constitutional protection for bonds because that's not the point of it. The point of it is that the bondholders could argue that under the Bankruptcy Code, pension holders do have to be impaired, even if the municipality doesn't want to, to achieve fairness in treatment.

MR. MONTGOMERY: Well, first, they would have to, of course, start on a class basis because obviously --

THE COURT: Right.

MR. MONTGOMERY: -- the unfair discrimination starts there, but, secondly, the key issue here for whether or not there is an unfair discrimination is whether or not there are differences in the protections afforded each claim. It is well-established that you can make distinctions between creditors based on the nature of the obligation and that you can make differences in treatment based on the nature of the obligation, so the only question is whether or not it's unfair, and how could it be unfair to let the pension rights of the City of Detroit retirees pass through a Chapter 9 case if the Michigan Constitution says it's unconstitutional to try to impair them?

THE COURT: The bondholders say protected by Constitution or not, in bankruptcy they are unsecured claims.

MR. MONTGOMERY: Right. And so if, your Honor, the only possibility of dealing with a pension obligation is that it has to be done in a Chapter 9 and it is unconstitutional for the actor, the state actors to ask for Chapter 9, I think you're blocked. You can't ask for the Chapter 9 position. And we find nothing inconsistent with that roadblock because the people of Michigan retain the right and the ability to change the law if they wish to give their municipalities greater access to Chapter 9. If, in fact, Article IX, Section 24, is a roadblock -- and we assert it is a

roadblock -- the people of Michigan, not the federal government, but the people of Michigan retain the right to make that change.

THE COURT: One more minute.

MR. MONTGOMERY: Yes, sir.

THE COURT: Ripeness. I would simply commend your attention to U.S. Postal Service v. National Association of Letter Carriers, which your Honor no doubt has read and which ripeness focuses on the timing of the action rather than the party that brings the action, and the key question there for the Court was whether or not there was a reasonable threat of liability if compliance with the arbitration order violated the CSRA, which was the relevant statute, and we say the analogy to that is whether or not there's a reasonable threat of harm to the pensioners as a result of the city's action.

THE COURT: Um-hmm.

MR. MONTGOMERY: And I think that's -- at least we would offer to your Court that is a difficult thing to dispute. And I think that exhausts my ten minutes, your Honor.

THE COURT: Thank you.

MR. SCHNEIDER: Your Honor, Matthew Schneider, chief legal counsel, Michigan Department of Attorney General, on behalf of the state. Your Honor, I'd only like to discuss two topics here. One is home rule and then, secondly, the

referendum issues regarding PA 436.

So if we start with the home rule argument, if we look at Article VII, Section 22, just setting aside the text, we have to look at the text and ask what does this do. What does this provision of the Constitution do? It gives local citizens the power to adopt their own governing structure and ordinances. And what it allows citizens to do is gives them a City Council. The City Council can adopt ordinances and resolutions. And the citizens have a right to that power.

In this case, what did the citizens do with that power? Look at Detroit City Charter, Section 1-102. They enacted as part of that charter a provision that reads, quote, "The City has the comprehensive home rule power conferred upon it by the Michigan Constitution, subject only to the limitations on the exercise of that power contained in the Constitution or this Charter or imposed by statute." So the charter itself states that the home rule power is limited to what is imposed by statute.

But even if it didn't say that, if the charter didn't say that, we know that when the citizens of Detroit go to the ballot box and they elect their City Council members, those same members, those same citizens, have an opportunity to vote for their state senator and their state representative and their governor, and those representatives in Lansing, who the city has an ability to vote for, pass

laws that govern those city residents as well. Those representatives passed PA 436.

This cannot possibly violate the home rule concept. Let's look at what those representatives did. They passed the Home Rule City's Act, MCL 117.36. Quote, "No provision of any city charter shall conflict with or contravene the provisions of any general law of the state," unquote.

And we have to look at this through another third and final prism. In 1963 the residents of this city had an opportunity to vote another time, and they voted to ratify the state Constitution. Article VII, Section 22, contains a very important line that now binds those city residents. A city, quote, "shall have the power to adopt resolutions and ordinances related to its municipal concerns, property and government, subject to the Constitution and law," unquote. The law is passed by the legislature. In other words, you can only pass local laws that are subject to the Constitution and the laws passed by the legislature, and this is all about representative government. This is how it works in our constitutional republic. The city residents still govern themselves. They voted for the people enacting the city charter. The city residents voted for a legislature that enacted PA 436, and the city residents had a hand in the Michigan Constitution as well.

If you look at the legal priority here, we know, as

I've stated, that the acts of the legislature can take priority over local acts. The Michigan Supreme Court in Mack v. City of Detroit, 467 Mich. 186, a 2002 case, explained this. There was a Detroit city charter provision that created a private cause of action for discrimination. A city police officer brought a discrimination suit under the charter, but in this case the legislature had already passed a governmental immunity statute that prevented these actions against the city. And the Michigan Supreme Court held that the charter provision conflicted with the law as passed by the legislature, and so the legislation took priority over the charter.

PA 436 is not a local act. It can be applied to any other city, and we can see in the newspapers today about the issue of PA 436 being raised in other cities or municipalities. So there's a much larger point here, your Honor. The objectors, I think, are incorrect in the overall approach to the home rule argument. They're arguing that PA 436 trumps home rule and ignores the will of the voters and that the legislature somehow just wanted to overrule the citizens of Detroit, but we have to look at PA 436 and know that there were incredibly compelling reasons for PA 436. The point of that, as spelled out in the Act, was to help distressed cities and school districts. The evidence showed that this was a problem that was not going away. It was true

before PA 4, after PA 4, before PA 436, and after it. And the language of PA 436 shows that the legislature wanted to fix it, but it also responded to the voters' rejection of PA 436. If we look at the governor's testimony in his deposition, he indicates as such.

THE COURT: Well, but the fact that there may have been compelling reasons for 436 wouldn't justify it if it's otherwise unconstitutional, would it?

MR. SCHNEIDER: No, but there's no -- it's not unconstitutional. That's my point.

THE COURT: I'm just wondering why you're arguing that it was compelling. What's the point?

MR. SCHNEIDER: It's a point because -- just to say, your Honor, there's a much larger point here, and the point is is this wasn't done arbitrarily. This was done for a very specific purpose.

Secondly, your Honor, I want to respond to the issue regarding the right to referendum. I believe Assistant Attorney General Margaret Nelson explained this quite adequately yesterday, but I do want to address the fact that, you know, there's been argument raised here that there were documents produced in discovery that lawyers at Jones Day discussed how PA 436 would be, you know, going around the referendum power. Well, neither of these people were members of the legislature. If we look at the governor's position

itself, the state has produced discovery in this case explaining the governor's position, and it was not to go around the legislature. The governor had directed -- I believe it was Dick Posthumus, the former lieutenant governor, and his legislative director, how are we going to craft -- how would PA 436 be crafted? It would be crafted not to ignore the will of the voters. It would be crafted in order to make sure that different changes were made to make it better. And, you know, as to --

THE COURT: But how does anyone know whether the changes that 436 incorporated over the rejected law, PA 4, responded to the will of the voters or not? How does anyone know that?

MR. SCHNEIDER: Well --

THE COURT: I mean all we know is PA 436 was repeal -- PA 4 was repealed.

MR. SCHNEIDER: Folks aren't blind, I think, to the media coverage as well. When an act is --

THE COURT: Rely on media coverage?

MR. SCHNEIDER: Well, they have constituents. Laws are passed only through the regular process of legislators responding to their constituents, and that is the will of the voters. And when the governor wants a new structure, PA 436, or the members of the legislature want that, their constituents will go to the media as well or will speak

directly to them, so it was in direct response to fixing the problems that the will of the voters pointed out.

If you have any other questions on these topics, I'd be happy to answer them or I could defer to Mr. Bennett on the other issues.

THE COURT: Thank you, sir.

MR. SCHNEIDER: Thank you.

MR. BENNETT: Good afternoon, your Honor. Bruce Bennett of Jones Day on behalf of the city. I got a little bit of an organizational challenge here. One comment with respect to the last point concerning the right of referendum, if the defect in 436 is that there was a right -- there should have been a right to referendum anyway, notwithstanding what the statute says, well, I suppose the remedy is for someone to try to mount a referendum, not to wait till you come to a Bankruptcy Court and ask the Bankruptcy Court to decide there should have been a referendum. If there had been a referendum, it would have been rejected, and, therefore, we're going to hold it unconstitutional. It seems that there's a whole -- there's a few steps that are being skipped in the relief that's been requested of you here.

There's a number of topics, and I can only refer to the other Mr. Bennett to cover all the different questions, so I'm going to try to organize it, but if it falls apart a

little bit, I apologize.

First, there was an appeal to the other California cases, which has to refer to Vallejo, where, of course, pension claims were not impaired, debt claims were impaired, in what was a largely consensual plan. I think I said in another appearance before this Court that today Vallejo may well be in trouble again and perhaps because it did not get enough relief from its debt generally, but that's not the reason I refer to it this time because I think you can't refer to Vallejo without referring to Central Falls in Rhode Island. And in Central Falls in Rhode Island, what happened was was that the pension claims, pension and benefit claims, took haircuts and the debt did not, again, a consensual outcome.

If the economics were a little different, perhaps we could have a consensual outcome one way or another in Detroit's case, but I'm pretty sure that the bondholders, who I think are listening on the phone and not here today, would say that they are not in a position and would not consent to allowing pension claims in this case to be unimpaired, and I've certainly heard the various representatives of those holding pension and other retiree benefit claims here and indicating that they're not in a position or willing to let bondholders leave unimpaired. And it may well be that this is the first case where irrespective of consent from one side

or another, we could not achieve that result, so I think the -- that a consensual outcome could come out differently and could come out with only part of a capital structure being impaired unfortunately says nothing about the controversy we have today.

The second point I want to cover is the point about the discharge language in Bankruptcy Code Section 944. It's, of course, important whenever reading a provision in a statute to figure out where it is in the statute, and the provision relating to discharge is in the effect of a confirmation order. And the line is that the discharge applies -- excuse me -- the debtor is not discharged -- there's a broader discharge provision that comes ahead -- from any debt exempted from discharge by the plan or order confirming the plan. This is not a claim that has some inherent nondischargeability. This is a reference to a plan exempting from the provision before it, and I suppose that what this is intended to do is to say that obligations as modified will continue if the plan or the order confirming the plan says so. Otherwise, if you go up and look at the discharge, it covers all claims, period, and so I think this is a provision that makes a plan that partially and does not fully discharge claims work, and I think that's all it is. It's not a recognition --

THE COURT: Well, but what Mr. Gordon argues, if I

understand it correctly, is that this provision of the Code allows a municipal debtor to waive the discharge of the claims of a class, and, therefore, this city can pursue a Chapter 9 case that addresses all of the debt other than the pension debt which can't be pursued or at least impaired because of the Michigan Constitution.

MR. BENNETT: Well, once again, this provision is one section in a Bankruptcy Code that contains lots of other sections, and a couple of them were touched upon by your Honor and other people addressing you just a few minutes ago.

First, there was a discussion about whether it creates a priority or not. I don't think that's terribly relevant. The issue that the Bankruptcy Code sets up is that it has a distribution scheme imbedded in it. The distribution scheme in some places is given effect through a combination of a declaration that a particular claim has priority and then a treatment requirement that you would find in 1129. In others there's no explicit priority, but there's a treatment -- there's a treatment requirement in 1129, and that treatment requirement works two ways, and I think this came out in the discussion. One, there's the ranking, which is basically what 1129(b) does between secured claims, unsecured claims, subordinated claims, and not in Chapter 9 equity. But it also has the nondiscrimination provisions, and I actually think that counsel for the retiree committee

slightly misspoke when he said, well, nondiscrimination, that's an issue between classes, and it is, but within classes there's actually a stronger nondiscrimination provision. The treatment within a class has to be the same. Between classes the rule is unreasonable discrimination. And so the discharge -- the provision in 944, the ability to have an exception in the confirmation order from discharging all claims that existed on the petition date and leaving some around to some extent, I don't think is a license to confirm a plan that doesn't meet with the requirements of 1129, both the priority -- what I called priority, but the distributional entitlement requirements and the creditor justice requirements, whether they are unlawful discrimination or same treatment within a class. And so you get to the point where your Honor was, I think, which is that these claims are --

THE COURT: Well, but Mr. Morris pointed out astutely that Chapter 9 itself prohibits -- or I should say requires that a plan be fair and equitable. Yes?

MR. BENNETT: It has a different meaning than the provision in the Chapter 11 --

THE COURT: Right.

MR. BENNETT: -- for -- yes.

THE COURT: Right.

MR. BENNETT: But he referred to best interest, but,

yes, it has a fair and equitable provision.

THE COURT: So he argues how can a provision that impairs pensions be fair and equitable in the face of the constitutional protection of them?

MR. BENNETT: I think you go back to the -- again, what came up when we were last here, which is that you can say as a constitutional matter these cannot be impaired for one -- by the municipality, but the reality is at the end of the day there isn't enough money. And when the reality is there isn't enough money to pay them, then if you went through all and exhausted all of the nonbankruptcy procedures for enforcing a debt, where would you be? That is the -- that is essentially the best interest benchmark. And we've got a lot of law on this. Bekins, which was referenced, is one of them. The fact pattern that you see in cases involving very distressed municipalities in the cases, which a lot of them are from the depression era, of course, is situations where the municipality, notwithstanding an obligation to raise taxes, just can't collect any more money no matter what it does. Sadly, that fact situation, albeit with more modern features, presents itself in Detroit. And I think it would be what the city will have to prove, open paren, one, in the event it does not achieve a consensual plan, which it still hopes to and that the -- that it is object -- the plan is objected to by relevant constituents

representing retirees, the city will ultimately have to prove that the distributions on account of underfunding claims offered by the plan are better than the contributions that could be achieved if there wasn't a Chapter 9 case and if the creditors were free to pursue their remedies, all creditors were free to pursue their remedies, and if the residents reacted as we can predict residents would react because they have been doing so for the past several decades. And if the city -- if the retiree -- committees represented by the retiree groups are able to prove that the environment for them outside of Chapter 9 is better than the results we are able to achieve in this Chapter 9 case, they may get a chance to prove to themselves whether they were right or wrong because that's where we'll be. We'll be in a dismissed case. There will be lots of unsatisfied bond debt. There will be lots of unsatisfied pension debt. There will be lots of unsatisfied OPEB debt, and we'll see how it turns out. I think that will not be a good outcome.

So this kind of brings me back to how the system works, and I think, frankly, why don't I start with really Justice Cardozo's reasoning? And first I wanted to spend a minute to take away some of the mystery that seems to be surrounding who was where in 1936 and 1938. It was mentioned that Judge Cardozo for some reason didn't participate in the decision in Bekins. Unfortunately, that's because Justice

Cardozo had a heart attack at the end of 1937, a stroke at the beginning of 1938, and he died in early July 1938, about ten weeks after the decision in Bekins. The reality was is Justice Cardozo was too sick to participate. His opinion was joined by, quote, the chief justice, Justices Brandeis and Justice Stone -- excuse me -- Justices Brandeis and Stone. I actually didn't know when we were here last for certain that the chief justice at the time of the dissent was the same Chief Justice Hughes who wrote the opinion in Bekins. It turns out he was. I was able to verify that during the break. And I think I offer what Justice Cardozo had to say because its logic is irrefutable. By the way, its reasoning wasn't assailed by any of the retiree representatives. It's joined by a very distinguished group of justices, and all of them except for Cardozo participated in the ultimate reversal of Ashton in Bekins. The opinion, of course, was written by Hughes, who joined the dissent, and I think, therefore, it's an excellent aid to interpretation.

I admitted last time that Bekins is a little hard to interpret because it's dealing actually with three specific constitutional challenges. It spends most of its column inches on the Article X problem. It spends exactly one column inch on the Fifth Amendment problem and really only talks about the commerce clause problem because the legislative history that it quotes for the changes made

between Ashton and Bekins touches on the commerce clause issue, and the Court basically is agreeing with the treatment that accompanied it -- accompanied the statute in the legislative history.

It turns out that Cardozo didn't write on a clean slate. He cited a case, Imperial Irrigation District, 10 Fed. Supp. 832, which is probably where he borrowed the concept, and I quote from that case, "The impairment of contracts is brought about by the national law, and not by the state measure, and local consent similar in effect to that sanctioned by the California statute." The judge in that case -- so it's obviously a district judge -- it's not even an appellate judge -- is dealing with the same problem that you would have if you tried to ground the constitutionality of the Bankruptcy Court -- Bankruptcy Code as against the contracts clause on anything other than the reality that it is the federal power that is impairing contracts. You wind up with a situation that you have basically destroyed Chapter 9 and maybe parts of Chapter 11 as an avenue for impairing contracts in many circumstances, not just pensions.

In short, you've proven too much. You've proven that contracts clauses in every state -- and I said last time I think there's a contracts clause in every state Constitution, but I could be off by one or two -- that would

prevent the impairment of bonds. That would prevent the impairment of trade claims. In fact, you would have effectively preempted all impairments, and Chapter 9 would be completely a dead letter. And so we have to look for other interpretations or we should be looking very hard for other interpretations, and we don't have to look very far. And as I said before, I think while Bekins says -- crunches it into a couple of sentences, Justice Cardozo's reasoning joined by Hughes, Stone, and Brandeis explains to us why, notwithstanding the federal contracts clause, notwithstanding state contracts -- state Constitution contracts clauses, and notwithstanding the pension clause, we still have an effective bankruptcy power to implement debt restructurings and debt impairments in cases where there are necessary -- where they are necessary. Nothing about eligibility is dealing with the question that your Honor sensibly asked, which is, "Don't you have to show that a plan is in the best interest of creditors?" Clearly we do. Is there anybody going to use Chapter 9 as a method for impairing contracts if they're not in financial extremis? No, they should not, and, no, they will not. It is in those circumstances where the federal government comes to the aid of states and municipalities that can't on their own restructure their financial affairs.

And by the way, a nice corollary of looking at it

this way is that it dovetails precisely with one of your Honor's observations, which is the last word -- I think it's the last word of the relevant sentence of the pensions clause, the words "thereby," which relate back to the state, relate back to the municipality, but don't say that they can't be impaired by anybody, just says the pension -- accrued pension benefits cannot be diminished or impaired thereby, "thereby" being the state and the municipality. So adopting the language and approach in the California case just cited, in the Cardozo dissent joined by the other justices, and in Bekins itself, albeit not quite as precisely, you wind up with federal law that happens to fit nicely with the actual language of the state law with a bankruptcy system that does still work and has not been crippled and made unable to deal with every financial -- every municipality in financial distress and a Bankruptcy Code that is constitutional, as Bekins said it was.

I don't think I have many more points. First, I wanted to make clear -- someone mentioned that the city had not in oral argument taken positions on certain points relating to PA 436. We've been relying and join in the arguments of the attorney general. I think I dealt with that. Oh, there was an assertion that the 1963 bankruptcy law was somehow different than the fact that throughout -- beginning in the '30s but all the way through '61, '63, all

the way up until the Bankruptcy Code made specific authorization unnecessary for awhile, Michigan authorized all of its municipalities to resort to the composition law. This 1963 law still had impairment of contracts as one of its central elements. In fact, if you look at Bekins, which stands, of course, for many things, Bekins is a case where it's a 60-percent -- it's a 60-cent distribution on account of debt, and it was a mercifully simple case. There was one class, so we didn't have to deal with discrimination and all those other things. But Bekins is a debt impairment case. It turned out to be that 86 percent of the creditors by amount approved it, and it's the 14 percent who are complaining. And so it really isn't fair to say that the bankruptcy laws as they apply to municipalities were vastly different than the laws that -- the laws that are here now. They're probably a little bit more advanced in certain respects, informed by the New York experience, but the idea that contracts between a municipality or obligations of a municipality because very often they're not just in the form of contracts, they're in the form of ordinances, and its creditors can be -- could be -- could have been in 1963 and in 1961 impaired as a matter of federal bankruptcy law. It's the absence of any mention at all of this issue or problem anywhere in -- specifically in the pensions clause itself, but also in the convention history leads to the conclusion

that people weren't thinking or it's hard to find any evidence that anyone was thinking that anything that happened in the structuring of the pensions clause was intended to take Chapter 9 relief away from a municipality, period, in any circumstances. And we think, again, that even if it did or tried to -- and I think this is important -- even if it did or tried to, the Justice Cardozo, Hughes, Stone, and Brandeis reasoning would say it doesn't matter, that at the end of the day, the -- unless there's an explicit direction not to file Chapter 9, the state can only protect pension claims so much. They can't protect them ultimately from federal power.

I think those are all the points I need to cover. If your Honor has any questions that I could answer --

THE COURT: No. Thank you.

MR. BENNETT: Thank you.

THE COURT: All right. Ladies and gentlemen, I promised you one deliverable at the conclusion of these arguments, which was a decision on whether or not there are any genuine issues of material fact that should be addressed at the upcoming trial relating to these issues which I had preliminarily determined were strictly legal issues. I'm going to take ten more minutes to just think about that. I think there might actually be one. So we'll reconvene at 2:45. In the meantime, I want to remind you, please, that

when you are in the hallway, you must remain absolutely silent, no talking in the halls. If you want to talk, you can talk in here or down on the first floor.

One other housekeeping matter, which, again, I want to bring up just in case I forget later. It was requested of the Court permission to have in the courtroom a transcriber to provide -- I guess it's called realtime transcripts, and that's fine with the Court so long as we all understand that that transcript is not the official transcript of the court and may not be used in lieu of what would otherwise be required to be used, the official transcript. So 2:45 we'll reconvene.

THE CLERK: All rise. Court is in recess.

(Recess at 2:34 p.m., until 2:46 p.m.)

THE CLERK: Court is in session. Please be seated. Recalling Case Number 13-53846, City of Detroit, Michigan.

THE COURT: Counsel are present. I want to emphasize again what I think I stated the other day, that the Court certainly will take into account in deciding these issues which I have preliminarily determined are legal issues any facts that come out in the trial that bear upon them. Having said that, though, there is one issue of fact that needs to be identified because the parties do disagree about it, and it might have a bearing on one of these legal issues, and that specific factual issue is what was the purpose of

adding the spending provision to PA 436.

Anything further for today? All right. We will begin our trial at nine o'clock Wednesday morning in this room. Oh, I urge you to get here early because the security lines are longer at that hour in the morning than they are at the times we've been starting.

THE CLERK: All rise. Court is adjourned.

(Proceedings concluded at 2:48 p.m.)

INDEX

WITNESSES:

None

EXHIBITS:

None

I certify that the foregoing is a correct transcript from the sound recording of the proceedings in the above-entitled matter.

/s/ Lois Garrett October 23, 2013

Lois Garrett